

C. Fiscal Responsibility

1. SDCERS

a. Governance¹²⁸⁹

Large pension systems have been at the forefront of investor demands to improve their governance by strengthening board independence and increasing transparency in financial matters. Government pension funds, particularly SCDERS, should demand no less of themselves. Therefore, the Audit Committee recommends the following changes in the governance structure of SCDERS:

i. Board Composition

As discussed below, as a result of a recommendation by the San Diego Pension Reform Committee, the current composition of the Board is as follows: there are seven citizens who are appointed by the Mayor, in addition to five member-elected representatives and one City Manager Designee. The Audit Committee believes the City of San Diego Pension Reform Committee's recommendation to improve the governance of SDCERS by changing the size and composition of the SDCERS Board was substantially correct.¹²⁹⁰ The Board should be comprised of qualified professionals with experience in the management of investment funds, as well as an understanding of and commitment to the fiduciary responsibilities owed to the System's retirees and employees. At the same time, it must be recognized that employees and retirees, whose contributions helped build the System's assets, have a direct financial interest in the system's welfare unlike any other, and that interest is deserving of respect. Accordingly, we believe the Pension Reform Committee's recommendation to increase the number of outside independent professionals on the Board is an improvement, but further improvements are necessary.

¹²⁸⁹ The Audit Committee is not the first body to have considered and recommended changes to the City's Retirement System, its financing or governance. The Pension Reform Committee, in its report on September 15, 2004, made 17 recommendations for improving the status of the system, including the following change in SDCERS governance:

Change the composition of the Retirement Board to seven members appointed by the City Council. These members will serve with staggered terms of four years each, with a two consecutive term maximum. Such appointees will have the professional qualifications of a college degree and/or relevant professional certifications, fifteen years experience in pension administration, pension actuarial practices, investment management (including real estate), banking, or certified public accounting. Such appointees will be U.S. Citizens and residents of the City of San Diego but cannot be City employees, participants (direct or indirectly through a direct family member) of the SDCERS, nor a union representative of employees or participants, nor can such appointees have any other personal interest which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.

Final Report, City of San Diego Pension Reform Committee at 14-21 (Sept. 15, 2004)

¹²⁹⁰ Final Report, City of San Diego Pension Reform Committee at 42-44 (Sept. 15, 2004) (recommending that the Board be changed to a seven-member body appointed by the City Council, rather than a 13-member body composed of representatives elected by various constituent member groups, management representatives, and appointees).

The composition of the Board of Administration of SCDERS should consist of nine members, including five members who shall be appointed by the Mayor and confirmed by the City Council. We believe a nine-member Board is small enough to encourage collaboration and collegial exchange of views, yet sufficient to oversee the Retirement Plan and the work performed by the approximately 60 employees of SDCERS. Mayoral appointees shall have the qualifications otherwise specified in the City Charter.¹²⁹¹ The remaining four members should consist of: (i) two members elected from police safety members, fire safety members, or general members of the retirement system, selected in accordance with Charter Section 144(d); and (ii) two retired members of the retirement system, selected in accordance with Charter Section 144(e). We note that currently, there are approximately 9,436 current employees of the City covered by the plan as well as 5,995 retirees.¹²⁹²

Given the System's precarious funding and rancorous history, the process of identifying and evaluating prospective SDCERS Board members should be undertaken with greater care than in the past. In connection with SDCERS Board vacancies in 2005, the Audit Committee observed that applicants for appointment were considered by the prior administration on the basis of incomplete, unsigned written forms and inadequate background investigations. In more than one instance, a routine background check performed at the Audit Committee's request revealed that the applicant had been associated with an entity once the subject of a regulatory investigation. We therefore recommend that, prior to any appointment being made to the SDCERS Board, each potential appointee be required to complete a written application listing qualifications for the position and any factors that may impact on that decision, and that the applicants be required to affirm the accuracy of the application. A background check of the applicants to be nominated should be done by the appropriate City department. The applications should also be shared with the Business and Governance Committee of the SDCERS Board.

ii. Board Committees

The Board of Administration should have standing committees to address board governance, compensation and evaluation of the Retirement Administrator, investments, and an audit and compliance committee. We understand that the SDCERS Board has already consolidated its former Business and Procedures Committee with its Rules Committee to form a single Business and Governance Committee, and

¹²⁹¹ San Diego City Charter, art. IX, § 144(a). The qualifications include: "No person who is a City employee, participant in the Retirement System, or City union representative may be eligible for appointment...Such appointees shall have the professional qualifications of a college degree in finance, economics, law, business, or other relevant field of study or a relevant professional certification. In addition, such appointees shall have a minimum of fifteen (15) years experience in pension administration, pension actuarial practice, investment management, real estate, banking, or accounting...Such appointees shall not have any other personal interests which would create a conflict of interest with the duties of a Board member and trustee."

¹²⁹² See Appendix F.